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How financial advisors can buy a wealth book of business
By Rob Burgess
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When it comes to buying or selling a book of business, it's not as straightforward as simply looking at the number of clients and amount of assets under management.

Experts say careful research into more detailed aspects is critical to a successful transaction. Additionally, client expectations can also make or break any potential deal.

What's it all worth?
But let's be honest — the numbers are an important starting point. Those looking to sell a book of business are presented with a decidedly different set of incentives than those on the other side of any potential deal.

"Every seller wants more, and every buyer wants to pay less," said Max L. Friar, managing partner at M&A advisory firm Calder Capital in Grand Rapids, Michigan, who has represented hundreds of owners in the sales or purchases of their businesses.

As a result, how to value the book of business will be the first possible point of contention. David Wood, founder and chief visionary officer of Gateway Financial Partners in Glastonbury, Connecticut, said he has assisted in almost 30 such transactions in the past three years. He said revenues are a starting point to a valuation "but there are many other factors including product mix, age of the clients and the client services model."

The most robust way to approach the value of a book of business is to estimate the cash profits that the book of business is expected to bring, said Michael Blake, founder of strategic consulting firm High Score Strategies, who likes to think of himself as a "risk sherpa."

"What percent of the book of business will go away when the owner does?" he said. "How profitable are the customers that remain? How long will the customers remain after the book of business is sold? What is the seller willing to do to ensure the transition of the book of business to the buyer?"

This disparity in estimating worth can make a deal fall apart before it even gets off the ground. Christopher Mankoff, a financial planner with JTL Wealth Planners in Plano, Texas, said he was recently involved in negotiations to purchase a small book business in a different state. He said he valued the book of business based on each client and put a different multiple depending on age; assets; contributions; distributions; type of account, whether tax-deferred,

taxable or tax-exempt; concentration of assets; and percentage of assets being deposited and withdrawn.

"The seller was asking for the industry-high multiple based on the revenue, which I felt was overvalued," he said. "Obviously as a seller, you want to receive as much as possible, but as a buyer, it is important to assess each client in the book to determine each client's value and for a fair price to pay."

In this case, Mankoff said what the seller was asking and what he determined was a fair value were far off. There were 35% of assets in two clients and 38% of the book making annual distributions.

"I walked away from the deal," he said. "If you are considering purchasing a book of business, take the time to review each client you would be acquiring and figure out what a fair price is. If you decide to pay a flat multiple without understanding each client's value, you may find yourself wishing that you had."

Having an outside opinion can help turn the valuation temperature down. Dan Franklin, chief strategy officer of investment firm handl Group, said it's always best to seek a professional assessment when determining the value of a book of business, whether buying or selling.

"An external advisor brings in an impartial opinion and ensures that the business or book of businesses is prepared for the required scrutiny during diligence exercises," he said. "You'll also benefit from access to a network of potential buyers, and invaluable experience in managing the sales process to ensure a timely sale without increasing pressure on management teams. Engaging an external advisor to help value a potential business acquisition from the buy-side can be useful in either confirming or challenging your own value calculations."

Successful relationship transfer requires careful study

Let's say common ground can be located between the buyer and seller on valuation and terms. Will the clientele remain once the deal is completed?

"Clients will often stay as long as there is no change for them [in terms of] fees, custodian or investment methodology," said Tom Balcom, CFP and founder of 1650 Wealth Management in Lauderdale-by-the-Sea, Florida, who has been involved in both the buying and selling sides of the equation.

Are the expectations and culture compatible? This question has confronted Derrick Alexander, owner and lead financial advisor at Greater Works Wealth in Tulsa, Oklahoma, who said he has been exploring the acquisition of a practice for almost two years.

"Recurring revenue is good," he said. "Profitability is great. But successful relationship transfer? That's priceless. To sell a practice effectively, you really need all three. If you're lacking in any one area — recurring revenue, profitability or transferable relationships — it will likely impact your valuation

and the overall success of the transition."

One of the more eye-opening experiences Alexander had was with an older advisor. He said it was, on paper, "a near-perfect fit."

"But what I learned is that many sellers want to pass their business on to someone who reflects their identity or who offers a similar, or broader, scope of services," he said. "In this case, the advisor told me, 'You're a great advisor. The only difference is that you're Black, and I'm Irish.' Crickets on the phone. I didn't expect that to be a deciding factor, but it was an important, and frustrating, lesson. … Make sure the seller's culture, values and client expectations align with your vision."

Client count and structure matter, Alexander said, and that while two firms might generate the same revenue, "they're not always equal in value."

"If I bring in $500,000 from 50 clients and you make $500,000 from 120 clients, your practice may be more time-intensive and operationally complex," he said. "For an acquiring firm, that means a lower value per client and more hours required to maintain the book — possibly turning what looks like a good deal into a bad one."